

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Refer Reply To:
CC:CORP:B03
PLR-132673-07
Date:
October 05, 2007

Legend

Parent =

Distributing =

Controlled =

Distributing LLC =

Controlled LLC =

Business A =

Business B =

Manufacturing Activities =

Individual C =

Individual D =

State X =

v =

w =

y =

z =

b =

c =

Officer A =

Officer B =

Transaction Agreements =

Transition Agreements =

Tax Allocation Agreement =

Dear _____ :

This letter responds to your July 16, 2007 request for rulings on certain Federal income tax consequences of a proposed transaction. The information submitted in that letter and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by penalty of perjury statements executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Share Distribution (defined below): (i) satisfies the business purpose requirement of §1.355-2(b) of the Income Tax Regulations, (ii) is being used principally as a device for the distribution of earnings and profits of Distributing or Controlled or both (see §355(a)(1)(B) of the Internal Revenue Code of 1986, as amended (the "Code") and §1.355-2(d)), or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest in Distributing or Controlled (see §355(e) and §1.355-7).

Summary of Facts

Parent, a State X corporation, is a publicly traded company and the common parent of an affiliated group of corporations filing a consolidated Federal income tax return. Parent is directly engaged in Business A and Business B. Parent has one class of common stock outstanding. Individual C owns z percent of Parent. The public owns the remainder of Parent.

Parent maintains certain stock option plans pursuant to which Parent has granted to its employees and directors options to purchase shares of Parent common stock (the "Parent Options"). Parent also maintains certain restricted stock unit plans pursuant to which Parent grants Parent restricted stock units to its employees and directors ("Parent RSUs").

Distributing, a State X corporation, is newly formed for purposes of the proposed transaction. Distributing has one class of common stock, all of which is held by Parent.

Controlled, a State X corporation, is newly formed for purposes of the proposed transaction. Controlled has one class of common stock, all of which is held by Distributing.

Distributing LLC, a State X limited liability company, is newly formed for purposes of the proposed transaction. All of the membership interests of Distributing LLC are held by Parent and Distributing LLC is disregarded as an entity separate from its owner for Federal income tax purposes.

Controlled LLC, a State X limited liability company, is newly formed for purposes of the proposed transaction. All of the membership interests of Controlled LLC are held by Distributing and Controlled LLC is disregarded as an entity separate from its owner for Federal income tax purposes.

Financial information has been submitted which indicates that Business A and Business B each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

For what are represented to be valid business reasons, management of Parent proposes to undergo the following series of transactions (collectively, the "Proposed Transaction"):

Proposed Transaction

(i) Parent will merge with and into Controlled LLC with Controlled LLC surviving the merger (the "Controlled Merger"). In the Controlled Merger, each share of Parent common stock will be exchanged for one share of Distributing common stock.

(ii) After the Controlled Merger, Controlled LLC will contribute Business A to Distributing LLC (the "Business A Contribution"). Immediately after the Business A Contribution, Controlled LLC will distribute all of its interests in Distributing LLC to Distributing (the "LLC Distribution").

(iii) After the LLC Distribution, Distributing will transfer all of its interests in Controlled LLC to Controlled (the "Business B Contribution").

(iv) After the Business B Contribution, Distributing LLC will incur approximately \$b of indebtedness (the "Debt Financing") from third party sources.

(v) After consummation of the Debt Financing, Distributing LLC will distribute to Distributing all of the proceeds of the Debt Financing (less any cash retained by Distributing LLC) and Distributing will contribute to Controlled (the "Cash Contribution") all of the proceeds of the Debt Financing (less approximately \$c to repay existing indebtedness and any cash retained by Distributing and Distributing LLC). Distributing

LLC will remain the obligor on the indebtedness incurred in the Debt Financing. Controlled will use the funds it receives in the Cash Contribution for the reasonable needs of Business B.

(vi) After the Cash Contribution, Distributing will distribute, pro rata, all of the common stock of Controlled to holders of record of Distributing common stock (the "Share Distribution").

(vii) As of the effective time of the Share Distribution, Distributing and Controlled will enter into various agreements (the "Transaction Agreements").

(viii) Under the terms of the Transaction Agreements: (i) each Parent Option held by an employee or director of Business A that is outstanding immediately before the Share Distribution will be converted into an option to acquire Distributing common stock (the "Distributing Options"), with the same terms and conditions as the corresponding Parent Option except that appropriate adjustments will be made as necessary by reason of the Proposed Transaction; and (ii) each Parent Option held by an employee or director of Business B that is outstanding immediately before the Share Distribution will be converted into an option to acquire shares of Controlled common stock (the "Controlled Options"), with the same terms and conditions as the corresponding Parent Option except that appropriate adjustments will be made as necessary by reason of the Proposed Transaction.

(ix) Parent RSUs will be converted into Distributing restricted stock units ("Distributing RSUs") for employees who will be employed by Business A following the Proposed Transaction or Controlled restricted stock units ("Controlled RSUs") for employees who will be employed by Business B following the Proposed Transaction, with the same terms as the corresponding Parent RSU except that appropriate adjustments to the RSUs will be made as necessary by reason of the Proposed Transaction.

(x) As of the effective time of the Share Distribution, Distributing and Controlled will enter into various transitional agreements (the "Transition Agreements"). Under the Transition Agreements, Distributing and Controlled will share employees for certain administrative functions and manufacturing functions. However, such sharing of employees will continue for no longer than v months following the Proposed Transaction, except for y employees who carry out Manufacturing Activities. Such employees will be shared for no more than w months following the Proposed Transaction.

Individual C will serve as a director and Officer A of both Distributing and Controlled and Individual D will serve as Officer B of both Distributing and Controlled to ensure a smooth transition. Distributing expects a new Officer A and Officer B will begin to serve within one year of the date of the Proposed Transaction. One year following

the Proposed Transaction, no person will serve as an executive officer of both Distributing and Controlled.

Representations

The following representations have been made regarding the Controlled Merger:

- (a) The fair market value of the shares of Distributing common stock and other consideration (if any) received by each Parent stockholder will be approximately equal to the fair market value of the Parent stock surrendered in the exchange.
- (b) Immediately following consummation of the Controlled Merger, and prior to the Share Distribution, the stockholders of Parent will own all of the outstanding Distributing stock and will own such stock solely by reason of their ownership of Parent stock immediately prior to the Proposed Transaction.
- (c) Distributing has no plan or intention to issue additional shares of its stock following the Controlled Merger.
- (d) Immediately following consummation of the Controlled Merger, and prior to the Business B Contribution, Distributing (through Distributing LLC) will possess the same assets and liabilities as those possessed by Parent immediately prior to the Proposed Transaction. Assets used to pay expenses incurred in connection with the Controlled Merger, and all redemptions and distributions (except for regular, normal dividends) made by Parent immediately preceding the Proposed Transaction will, in the aggregate, constitute less than one percent of the net assets of Distributing.
- (e) Other than Parent Options and benefit plans for employees and directors, and other than in connection with an outstanding indemnity arrangement, at the time of the Controlled Merger, Parent will not have outstanding any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in Parent.
- (f) Distributing has no plan or intention to reacquire any of its stock issued in the Controlled Merger.

- (g) The liabilities of Parent assumed by Distributing plus the liabilities (if any) to which the transferred assets are subject were incurred by Parent in the ordinary course of its business and are associated with the assets being transferred.
- (h) The Parent stockholders will pay their respective expenses, if any, incurred in connection with the Controlled Merger.
- (i) Parent is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of §368(a)(3)(A).

The following representations have been made regarding the Business B Contribution, the Cash Contribution, and the Share Distribution:

- (j) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (k) The five years of financial information submitted on behalf of Distributing regarding Business A (to be conducted through Distributing LLC) is representative of the present operations of Business A, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (l) The five years of financial information submitted on behalf of Controlled regarding Business B (to be conducted through Controlled LLC) is representative of the present operations of Business B, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (m) Following the Proposed Transaction, Distributing and Controlled will each continue the active conduct of its active business, independently and with its separate employees except for the post-transaction arrangements set forth in the Transition Agreements. Payments made by each of Distributing and Controlled to the shared employees for services rendered by the shared employees will be for approximately fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (n) The Share Distribution is carried out for the following corporate business purposes: (i) to facilitate a borrowing by Business A on the most favorable of terms; (ii) to permit Business B to raise a substantial amount of capital to fund Business B operations, capital expenditures, acquisitions, and other business needs; (iii) to enhance the ability of

each of Business A and Business B to raise a substantial amount of equity capital on an efficient basis; (iv) to increase aggregate share value which may permit Distributing and/or Controlled to effect acquisitions in a manner that preserves capital with significantly less dilution; and (v) to enhance Distributing and Controlled's compensation structure in order to attract, motivate, and retain key employees. The Share Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.

- (o) The Proposed Transaction is not used principally as a device for the distribution of the earnings and profits of Distributing and Controlled or both.
- (p) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the Proposed Transaction, except in the ordinary course of business.
- (q) The total fair market value of the assets contributed to Controlled by Distributing in connection with the Business B Contribution will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of §357(d)) by Controlled in the exchange, (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of cash and the fair market value of any other property (other than stock and securities permitted to be received under §361(a) without recognition of gain) received by Distributing in the exchange. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the Business B Contribution.
- (r) The total adjusted basis and the fair market value of the assets transferred by Distributing to Controlled in the Business B Contribution each will equal or exceed the sum of (i) the total liabilities assumed (within the meaning of §357(d)) by Controlled (if any), and (ii) the total amount of any money and the fair market value of any other property (within the meaning of §361(b)) received by Distributing and transferred to its creditors in connection with the reorganization.
- (s) Any liabilities assumed (within the meaning of §357(d)) by Controlled in the Business B Contribution were incurred in the ordinary course of business and are associated with the assets transferred.

- (t) The total fair market value of the assets transferred to Controlled by Distributing in connection with the Business B Contribution will equal or exceed the aggregate adjusted basis of those assets.
- (u) The income tax liability for the taxable year in which investment credit property (including any building to which §47(d) applies) is transferred (if any) will be adjusted pursuant to §§50(a)(1) or (a)(2) (or §47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.
- (v) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.
- (w) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Share Distribution, except for obligations that may arise after the Proposed Transaction pursuant to the Transition Agreements.
- (x) Immediately before the Share Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. Distributing's excess loss account with respect to Controlled stock, if any, will be included in income immediately before the Share Distribution (§1.1502-19).
- (y) Except for certain payments that will be made in connection with the Tax Allocation Agreement, payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be for approximately fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (z) No two parties to the Proposed Transaction are investment companies as defined in §§368(a)(2)(F)(iii) and (iv).
- (aa) The payment of cash in lieu of fractional shares of Controlled stock is solely for the purpose of avoiding the expense and inconvenience to Controlled of issuing fractional shares and does not represent separately bargained for consideration. The total cash consideration, if any, that will be paid in lieu of fractional shares of Controlled stock will not exceed one percent (1%) of the total consideration that will be issued in the Share Distribution.

- (bb) The indebtedness owed by Controlled to Distributing after the Share Distribution, if any, will not constitute stock or securities.
- (cc) For purposes of §355(d), immediately after the Proposed Transaction, no person (determined after applying §355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in §§355(d)(5) and (8)) during the five-year period (determined after applying §355(d)(6)) ending on the date of the Share Distribution.
- (dd) For purposes of §355(d), immediately after the Proposed Transaction, no person (determined after applying §355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in §§355(d)(5) and (8)) during the five year period (determined after applying §355(d)(6)) ending on the date of the Share Distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in §§355(d)(5) and (8)) during the five year period (determined after applying §355(d)(6)) ending on the date of the Share Distribution.
- (ee) The Share Distribution is not part of a plan or series of related transactions (within the meaning of §1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest (within the meaning of §355(d)(4)) in Distributing and Controlled (including a predecessor or successor of any such corporation).
- (ff) Immediately after the transaction (as defined in section 355(g)(4), either (1) neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of 355(g)(2)), or (2) no person will hold a 50-percent or greater interest (within the meaning of section 355(g)(3)) in the stock of Distributing or Controlled.
- (gg) There is no plan or intention by Individual C, C's spouse or entities that hold shares of Parent common stock on behalf of C or one or more members of C's immediate family to sell, transfer or otherwise dispose of any of the Distributing common stock or Controlled common stock he, she or it will hold after the Proposed Transaction.

Based solely on the information submitted and the representations set forth above, we rule as follows with respect to the Controlled Merger:

- (1) The Controlled Merger will qualify as a reorganization under §368(a)(1)(F). Parent and Distributing will each be a “party to a reorganization” under §368(b).
- (2) No gain or loss will be recognized by the shareholders of Parent upon their exchange of Parent shares for shares of Distributing common stock (§354(a)).
- (3) No gain or loss will be recognized by Parent in the Controlled Merger (§§357(a) and 361(a)).
- (4) No gain or loss will be recognized by Distributing in the Controlled Merger (§1032(a)).
- (5) The basis of each asset of Parent in the hands of Distributing will be the same as the basis of that asset in the hands of Parent immediately prior to its transfer (§362(b)).
- (6) Distributing’s holding period for each asset of Parent will include the period during which such asset was held by Parent (§1223(2)).
- (7) The basis of the Distributing common stock received by each Parent shareholder will be the same as the basis of the Parent stock surrendered by the stockholder in the exchange (§358(a)(1)).
- (8) The holding period of the Distributing common stock received by each Parent shareholder will include the period during which the Parent shares were held by the shareholder, provided that the Parent shares were held as capital assets on the date of the exchange (§1223(1)).
- (9) The tax year of the Parent affiliated group will not end on the date of the Controlled Merger and such tax year will continue with Distributing as the successor to Parent in its capacity as the common parent of the affiliated group of corporations of which Parent was the common parent (§§1.381(b)-1(a)(2) and 1.1502-75(d)(2)(i)).

Based solely on the information submitted and the representations set forth above, we rule as follows with respect to the Business B Contribution, the Cash Contribution, and the Share Distribution:

- (10) The Business B Contribution and the Cash Contribution, together with the Share Distribution, will be a reorganization within the meaning of §368(a)(1)(D). Distributing and Controlled will each be a “party to a reorganization” within the meaning of §368(b).
- (11) No gain or loss will be recognized by Distributing on the Business B Contribution and the Cash Contribution (§§357(a) and 361(a)).
- (12) No gain or loss will be recognized by Controlled on the Business B Contribution and the Cash Contribution (§1032(a)).
- (13) The basis of the property received by Controlled in the Business B Contribution will be the same as the basis of such property in the hands of Distributing immediately prior to the Business B Contribution (§362(b)).
- (14) The holding period of the property received by Controlled in the Business B Contribution will include the period during which such property was held by Distributing (§1223(2)).
- (15) No gain or loss will be recognized by Distributing upon the distribution of all of its shares of Controlled stock in the Share Distribution (§361(c)).
- (16) No gain or loss will be recognized by, and no amount will be included in the income of, the shareholders of Distributing upon the receipt of the Controlled stock in the Share Distribution (§355(a)(1)).
- (17) The aggregate basis of the stock of Distributing and Controlled held by Distributing shareholders immediately after the Share Distribution will be the same as the aggregate basis of the Distributing stock held by Distributing shareholders immediately before the Share Distribution, allocated between the Distributing stock and Controlled stock in proportion to the fair market value of each in accordance with §1.358-2(a)(2) (§358(a)(1), (b), and (c)).
- (18) The holding period of the stock of Controlled received by Distributing shareholders in the Share Distribution will include the holding period of the Distributing stock on which the Share Distribution is made, provided that Distributing shareholders held the stock of Distributing as a capital asset on the date of the Share Distribution (§1223(1)).
- (19) As a result of the Share Distribution, the earnings and profits of Distributing will be allocated between Distributing and Controlled in accordance with §312(h), §1.312-10(a), and §1.1502-33(e)(3).

- (20) Payments made between Distributing and Controlled or their subsidiaries under the Transaction Agreements and the Tax Allocation Agreement that (i) have arisen or will arise for a taxable period ending before the Proposed Transaction and (ii) will not become fixed and ascertainable until after the Proposed Transaction, will be treated as occurring immediately before the Share Distribution. Any cash payment from Controlled to Distributing under the Transaction Agreements or the Tax Allocation Agreement, up to the amount of the Cash Contribution, will be treated as an adjustment to the Cash Contribution.

Caveats

No opinion is expressed about the tax treatment of the Proposed Transaction under other provisions of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings.

In particular, we express no opinion regarding the Federal income tax consequences of the conversion of the Parent Options described in step (viii) of the Proposed Transaction or the Federal income tax consequences of the conversion of Parent RSUs described in step (ix) of the Proposed Transaction.

Procedural Statements

This ruling letter is directed only to the taxpayers who request it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any Federal income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of this ruling letter.

Under a power of attorney on file in this office, copies of this letter are being sent to your authorized representatives.

Sincerely,

Ross E. Poulsen
Assistant to the Branch Chief, Branch 3
Office of Associate Chief Counsel
(Corporate)